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Chiang Releases Long-Term Costs for Paying Future State Retiree Health Benefits

SACRAMENTO – State Controller John Chiang today unveiled a new actuarial report that shows California faces a $48.2 billion bill to pay for retired state employees' health and dental benefits.

"Even as the State grapples with a decline in revenues during difficult economic times, it is important for lawmakers to begin crafting a long-range plan to meet this future obligation in a way that will have the smallest impact on the state's pocketbook," Chiang said. "By setting aside additional dollars that can be invested in the future, we can grow new funds to pay for the health benefits we have promised our retirees in a responsible and fiscally prudent manner."

The unfunded obligation is $340 million more than the projected $47.8 billion obligation identified in the Controller's first actuarial report, released in May 2007. That report expected this year's obligation would rise to $50.4 billion, but that growth was avoided primarily by the California Public Employees' Retirement System (CalPERS) use of surplus funds to reduce the increase in health care premium costs rates for the CalPERS self-funded plan.

Chiang noted CalPERS, the nation's largest public pension fund and the nation's third largest purchaser of health care benefits, is making important strides to address the growth of health care costs by improving pharmacy management with incentives to use generic drugs, working with PERS plan partners to develop lower cost options, and promoting strategies for plan members to stay well and make smart choices about their health care. As a member of the governing board, he will continue to urge CalPERS to develop and implement strategies for keeping members healthy and reducing long-term costs through preventative health programs. However, he cautioned that the state cannot depend on similar surpluses in the future.

In 2004, the Governmental Accounting Standards Board Statement 45 (GASB 45) required states and local governments to publicly disclose the future costs of paying for post-employment benefits other than pensions for current state retirees and employees. Although California's actuarial obligation was not required to be disclosed until its financial statements for the 2007-08 fiscal year are released in March 2009, Chiang ordered the early release to give lawmakers the opportunity to include the unfunded obligation and health care cost containment in budget talks.

Both actuarial reports focused on a "closed group" population, as required by the GASB reporting regulation. A "closed group" analysis reflects only the present value of retiree health benefits for current state employees and retirees, not the benefits associated with future state employees hired after the valuation date.

California currently pays for state retiree health benefits on a "pay-as-you-go" basis, meaning the costs are paid as they come due each year. The latest actuarial report estimated California's obligation for retiree health and dental benefits based on two different funding scenarios:

- The current pay-as-you-go policy results in an actuarial unfunded obligation of $48.2 billion, which represents the total present value of future retiree health benefits earned to date by current state retirees and employees. Based on this unfunded obligation, California has an "annual required contribution" of $3.72 billion for 2008-09 – or the amount the State would need to pay to fund these benefits. In the 2008-09 Budget Act, the State only provided $1.36 billion for the health benefits.
- A full-funding policy results in an actuarial unfunded obligation of $31.2 billion. The amount is lower than the actuarial unfunded obligation under the pay-as-you-go policy because the costs of future benefits are fully pre-funded. Pre-funding permits the State to earn investment income on the amounts set aside to fund future benefits. That investment income can be used to help offset the costs. The State would need to contribute $2.68 billion in 2008-09 to fully fund its obligation.

The report showed that even partially funding the obligation would cut the actuarial unfunded obligation to $38.3 billion, assuming the State paid $2.02 billion of the $3.09 billion needed to meet the obligation for 2008-09.

While GASB does not require states to fully fund its obligations, all three credit rating agencies have urged states to at least have a plan in place for funding to avoid any future downgrades.

Projecting the three scenarios out over 10 years shows the actuarial unfunded obligation would grow from $48 billion to $71 billion in 2017-18 under a pay-as-you-go scenario. Full funding would increase the unfunded obligation from $31 billion to $48 billion. Partial funding would increase the unfunded obligation from $38 billion to $58 billion.

Projected employer contributions initially are the lowest under the pay-as-you-go scenario. But if contributions in excess of those costs are made, investment income can be used to finance benefit costs and bring down the employer costs. After approximately 14 years, the State's contributions under full funding are expected to be less than its contributions under the pay-as-you-go scenario.

The actuarial report and the supplemental closed group projection letter can be found on the Controller's Web site at www.sco.ca.gov.

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